No. 5661

In the

United States Circuit Court of Appeals

For the Ninth Circuit

PORTLAND CREMATION ASSOCIATION
Petitioner and Appellant

vs.

COMMISSIONER OF INTERNAL REVENUE
Respondent and Appellee

Upon Petitions to Review Orders of the United States Board of Tax Appeals

Brief of Petitioner and Appellant

CAREY & KERR
CHARLES E. McCULLOCH
IVAN F. PHIPPS
Attorneys for Petitioner and Appellant
1410 Yeon Building
PORTLAND, OREGON

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STATEMENT OF THE CASE

This is a proceeding pursuant to the provisions of Section 1001 of the Revenue Act of 1926 (44 Stat. 9) as amended by Section 603 of the Revenue Act of 1928, for the review of decisions of the United States Board of Tax Appeals in favor of the Commissioner of Internal Revenue and against the Portland Cremation Association, petitioner before the Board and appellant herein. There were three separate proceedings before the Board. They

were consolidated for hearing and decision. However, three separate judgment orders or orders of redetermination were entered by the Board and three separate petitions for review were filed in this Court. The three proceedings by stipulation of the parties have been consolidated for the purpose of preparation and filing of briefs and for hearing and decision by this Court.

These appeals involve a single question, whether the Commissioner of Internal Revenue properly added to appellant's taxable income certain amounts received by appellant in connection with the sale of vaults, urns and niches for the burial of the dead or within which to place the ashes resulting from the incineration of human remains, which amounts were placed in a permanent maintenance fund which was to be used and which was used exclusively for the maintenance of the property so sold.

There is no dispute as to the facts. They were stipulated in writing by the parties. The question presented for decision by this Court is whether the facts so stipulated and found by the Board of Tax Appeals are sufficient in law to sustain the Board's decision affirming the Commissioner's action in including the amounts placed in the permanent maintenance fund in appellant's taxable income.

The years involved in this appeal are the years 1919, 1920, 1921 and 1922. During each of these

years appellant placed in a permanent maintenance fund twenty per cent. of the gross receipts from sales of vaults, niches and urns, the aggregate amount for the four years being $65,348.12. Each sale of a vault or niche in appellant's mausoleum or columbarium was evidenced by a grant or conveyance of space in the form of a deed. Such deed contained a covenant to maintain the deeded property forever. For the most part the moneys representing this maintenance fund were invested in United States Liberty Bonds and War Savings Stamps. The income from the fund was mingled with income of the appellant and was used for the sole purpose of maintaining the property. During all of the years in question the income from the permanent maintenance fund was insufficient to maintain the property in good condition without the addition of funds belonging to appellant. No part of the principal of the permanent maintenance fund was ever used for the maintenance of the property. At the end of 1922 the permanent maintenance fund in the sum of $65,348.12 was intact. At the time of each sale of vaults, niches and urns, representations were made to the purchaser that the property would be maintained perpetually and that such maintenance was backed up or guaranteed by a permanent maintenance fund, that a portion of the amount paid by the purchaser would be placed in such permanent maintenance fund and

that said fund would be and could be used for no other purpose.

During the years in question no dividends were declared or paid. (Transcript of Record, pages 40 to 66, and pages 67 to 72.)

ARGUMENT

I.

The United States Board of Tax Appeals erred in deciding that those portions of the amounts received by appellant in the years 1919, 1920, 1921 and 1922 from the sale of niches, urns and burial vaults, which were set apart in a fund for the permanent maintenance of the property were properly included by the Commissioner in appellant's taxable income for said years.

It is apparent from the facts outlined above, which are clearly set forth in the written stipulation of facts and in the findings of fact made by the Board of Tax Appeals, that the moneys placed in the permanent maintenance fund did not inure to the benefit of the appellant as assets subject to disposition as appellant might see fit, but immediately became and at all times remained a trust fund for the benefit of the owners of vaults, urns and niches. Upon any intimation that the fund was

being improperly used or turned to purposes other than that for which it was created, namely, the perpetual care of the property, the appellant would have been subjected to the instant protest of indignant purchasers and immediate litigation to compel it to carry out the terms of the trust and use the funds in accordance with its understanding and agreement with the purchasers. We have no doubt that any court having jurisdiction, upon proof of the use of the permanent maintenance fund for any other purpose, would have entered its decree confirming the trust and taking from appellaant the control and custody of the fund itself.

It was not the purpose of the various Revenue Acts of the United States to tax as income moneys which under no circumstances could belong to or inure to the benefit of a taxpayer or be used for his private advantage. The doctrine has been repeatedly announced in debates in Congress and in decisions of the courts that the law seeks to tax only that which is in truth income and not that which is not income in fact, although perhaps having the appearance of income.

The history of the taxation of cemetery companies in connection with their permanent maintenance funds is interesting. In an excess of zeal the Commissioner of Internal Revenue from the very start sought to impose a tax upon all receipts of such companies and to include in such receipts

subject to tax all moneys placed in permanent maintenance funds whether such funds were subject to express trusts or to implied trusts, and whether the custody of such funds and of the income therefrom was in the hands of the cemetery companies or in the hands of independent trustees representing the individual owners of burial lots and vaults. Quite naturally the cemetery companies objected to the imposition of taxes on funds which did not and could not inure to their benefit but it was only after the creation of the United States Board of Tax Appeals that public decisions on this important question began to be made and the power and authority of the Commissioner to be abridged.

There have been six decisions of the United States Board of Tax Appeals involving the taxability of these maintenance funds, and there has been one decision by the United States Courts. The cases to which we refer are as follows:

Appeal of the Los Angeles Cemetery Association, 2 B. T. A. 495;

Appeal of Greenwood Cemetery Association, 2 B. T. A. 910;

Appeal of the Springdale Cemetery Association, 3 B. T. A. 223;

The Metairie Cemetery Association v. Commissioner of Internal Revenue, 4 B. T. A. 903;

Appeal of Troost Avenue Cemetery Association, 4 B. T. A. 1169;

Inglewood Park Cemetery Association v. Commissioner of Internal Revenue, 6 B. T. A. 386;

Troost Ave. Cemetery Co. v. United States, 21 F. (2d) 194.

It should be remembered that there is a practice whereby the Commissioner may acquiesce in decisions of the United States Board of Tax Appeals which are adverse to him. If he announces his formal acquiescence in a decision, that decision becomes binding upon the Commissioner and the principal laid down by the Board in its decision becomes the rule of law thereafter followed by the Commissioner. The Commissioner has acquiesced in all of the above mentioned Board decisions which were adverse to him, except that in *Inglewood Park Cemetery Association v. Commissioner of Internal Revenue.* In that case no acquiescence has yet been announced though the time for the Commissioner to appeal has expired and no appeal has been taken from the Board's decision.

We will briefly review the above mentioned decisions.

In the case of the Los Angeles Cemetery Association, 2 B. T. A. 495, decided September 8, 1925, it was held that amounts placed in a perpetual care fund by a cemetery association which agreed in consideration of specific payments to care for graves or plots in perpetuity, constituted trust funds under the California law, and it was spe-

cifically held that since none of these funds could be used for any purpose other than for such permanent maintenance, they could not be gain or income to the taxpayer. The Board in an opinion by Judge Graupner, used the following language:

> "The taxpayer sells nothing upon which a gain can be made to the person who enters into a contract for perpetual care; it takes nothing which it can use for its own purposes; it receives nothing which it may distribute to its stockholders; it holds nothing which it can ultimately distribute to itself for its own uses. The taxpayer as a trustee can exercise no discretion in the accumulation or distribution of the fund accumulated from perpetual care contracts. It is bound to perform a defined service with such fund and from that there can be no gain to be classed as income. We express no opinion whether interest or increment earned by such funds would be taxable as income."

This language applies equally to appellant's situation. The twenty per cent. which it received and agreed by formal resolution of its Board and by agreement with the purchasers to place in the permanent maintenance fund could not be used for its own purpose. It could not be distributed to its stockholders.

The next decision of the Board of Tax Appeals was in the Appeal of Greenwood Cemetery Association, 2 B. T. A. 910, decided October 19, 1925. The Greenwood Association was a Washington corporation. In 1893 it adopted rules and regula-

tions for the perpetual care of graves. Its contracts provided specifically that the amounts paid into the perpetual care fund should be held as a trust fund, the income from which alone was to be available by the Cemetery Association in caring for lots. The findings of fact contained this statement:

> "In the sale of perpetual care the stockholders of the association are benefited to the extent that the corporation uses the income of the perpetual care fund in the care of the cemetery and the payment of upkeep and running expenses in general, but the principal of the perpetual care fund is set up in a 'Liability Account' and the corporation is liable to the contributors of said fund for the perpetual care of graves as shown by the written agreement made by the corporation and each purchaser of perpetual care. The income from the perpetual care fund has been and is mingled with other income and was accounted for as income by the taxpayer in its 1918 and other income-tax returns."

Upon the authority of the Los Angeles Cemetery Association decision the Commissioner's attempt to include the trust fund payments in the Greenwood Company's income was disallowed. The Greenwood case differs from the present case in that the funds in the Greenwood case were made trust funds by express agreement, while in the case now before the court the trust is implied. In other respects the cases are identical, including particularly the circumstance that in both cases

the income from the trust fund has been mingled with funds of the taxpayer in the maintenance and care of the property.

The next case decided by the Board was that of Springdale Cemetery Association, 3 B. T. A. 223. The taxpayer was an Illinois corporation. The case was decided on December 21, 1925. It is the only one in which the decision has been in favor of the Commissioner. The decision contains the following findings of fact:

> "The corporation's by-laws contained no provisions for appropriating any part of receipts from the sale of lots as such perpetual care fund, and no resolution to that effect was passed by the directors. The directors by informal decision set up such a reserve on the books. The amount of 25 cents a square foot was an estimate of the amount required to provide a sufficient fund for future care."

The opinion in the Springdale case was by Mr. Sternhagen. The company's situation was clearly distinguished from that of the Los Angeles Cemetery Association. It was brought out that in Illinois it was permissive to create a trust fund for permanent maintenance and although the company's charter provided that the company might create by by-law funds for repair and maintenance the company had not seen fit to do so. The decision contains this language:

> "The taxpayer voluntarily set up a reserve based on an estimate, but there is lacking the

> clear evidence necessary to establish a trust. So far as the record shows, the directors might at any time reduce the fund or perhaps wipe it out, without restraint, their liability, if any, being one for breach of covenant or contract."

The Springdale case is to be distinguished from the case now on appeal in that in the Springdale case, there was no by-law or resolution of the directors calling for a perpetual care fund and there is no finding of fact whatsoever indicating that sales were made with any understanding or agreement that such fund should be maintained for the benefit of purchasers. Under the findings of fact made by the Board, the decision seems sound, since the fund set up on the books of account was quite apparently simply a reserve for future maintenance without any of the elements tending to make it a trust fund. It is settled law that such reserves for future maintenance are not deductible from gross income in computing taxable net income.

The next case before the Board was that of the Metairie Cemetery Association, 4 B. T. A. 903, decided September 22, 1926. The Metairie Association was a Los Angeles corporation. It made sales contracts of two kinds. In one class of contract there was a specific provision that the amount received by the Association was received in trust for the lot owner and that the income only on the amount so received was to be used for the purpose of upkeep of the cemetery lots and that such agree-

ment should continue perpetually. In the other class of contract there was no such provision. However, there had been a formal resolution of the Association's board of directors providing that all sums received by the Association in consideration of which it obligated itself to keep in perpetuity all tombs and surrounding grounds in good order were to be recognized as trust funds to be invested as the board of directors might direct, the income accruing therefrom to be alone expended. By a resolution of the directors adopted some years after the end of the years in dispute before the Board, all funds received for perpetual care contracts were specifically made subject to the trust whether or not covered by contracts containing the trust fund provisions. The findings of fact contained this statement:

> "While there were only thirteen of the perpetual-care contracts entered into during the taxable years involved which contained a specific provision to the effect that the funds received under such contracts were received in trust by the taxpayer, the other contracts entered into during the taxable years, as well as all of the contracts of perpetual care, were entered into with the specific understanding on the part of the corporation and the lot owners that the funds received by the corporation under such contracts would be held in trust for the specific purposes mentioned in the contract. The fact that the funds were received in trust was specifically explained to the lot owners by an officer of the corporation when

> the contracts were signed and it was definitely understood by all concerned that such funds were to be held in trust."

The Board decided this case in favor of the Cemetery Association upon the authority of its previous decisions, particularly that of the Los Angeles Cemetery Association, and it is interesting to note that the opinion opens with the following statement:

> "The Commissioner concedes that if the Board finds as a matter of law that the amounts received by the taxpayer under the perpetual-care contracts were received in trust, then the amounts are not taxable to the taxpayer but that the case would then be controlled by the decision of the Board in the Appeal of Los Angeles Cemetery Association."

The opinion contains also the following statement:

> "The evidence is that at the time the contracts were entered into it was agreed that the money would be held in trust for the specific purposes of the contract. This being true, we are of the opinion that a valid trust was created by parol in those contracts where there was no specific provision to that effect. The only reason that certain of the contracts contained that express provision was the fact that those lot owners insisted upon the agreement being included in writing in the contrcat."

The decisions heretofore cited adopted the practical and common-sense view of these permanent care funds and held them to be trust funds, the

facts and circumstances indicating that such was the understanding of the parties.

The next case decided by the Board was that of Troost Avenue Cemetery Association, 4 B. T. A. 1169, decided September 29, 1926. In that case the Association had placed the maintenance funds with a trust company. The Commissioner maintained that the creation of this trust fund was simply the creation of a reserve to provide for future expenses of the corporation. The decision was in favor of the taxpayer. The case is interesting only as showing the length to which the Commissioner went in attempting to exact taxes on funds of this character.

The last case decided by the Board was that of *Inglewood Park Cemetery Association v. Commissioner of Internal Revenue,* decided on March 2, 1927, 6 B. T. A. 386. The Inglewood Park Association was a California corporation. In the findings of fact it is stated that:

> "Salesmen employed by the petitioner were instructed to assure the purchasers of burial lots that 25 per cent. of the purchase price would go into a fund for the perpetual care of the lots. Each deed executed to convey title to purchasers of lots contains the following:
>
> 'Said lot is granted with right to the grantee for perpetual care thereof by and at the expense of said Cemetery Association'."

In the Inglewood Park case the Board sustained the position of the Cemetery Association and held that the assurance of salesmen that 25 per cent. of the purchase price would go into a fund for the perpetual care of the lots, accompanied by the covenant of the Association to care for the lots in perpetuity, constituted a parol agreement not in contravention of the writings, and that the amounts so placed in the perpetual care fund became trust funds and were not part of the income of the Association.

The case of *Troost Ave. Cemetery Co. v. United States*, 21 F(2d) 194, involved the taxability of the proceeds of sales of cemetery lots placed in the hands of a third party as trustee, such proceeds constituting a permanent maintenance fund. The facts were similar to those in the Troost Avenue case before the Board.

The Court decided in favor of the taxpayer, citing with approval the Los Angeles, Greenwood, Metairie and Troost Avenue decisions of the Board. The Inglewood case was decided by the Board only the day before the Court's decision and probably it had not come to the Court's attention.

We believe that the decisions of the Board of Tax Appeals mentioned above are in accordance with the purpose and letter of the various Revenue Acts, but we believe that the majority of the Board erroneously applied to the facts in the Portland

case the principles set forth in their previous decisions.

Again, we call attention to the following facts stipulated by the taxpayer and the Commissioner, for consideration in connection with the Board's decisions acquiesced in by the Commissioner:

1. The deeds given to purchasers of vaults and niches * * * contained a covenant running to the grantee and his heirs that the petitioner would maintain the columbarium containing said niche or vault forever.
2. The additions to the permanent maintenance fund were made pursuant to formal action of the board of directors and stockholders of the Association.
3. During the years involved in these appeals petitioner placed in a permanent maintenance fund twenty per centum of the gross selling price of all urns, niches and vaults sold by it.
4. "All sales by the petitioner were made with the representation to the purchasers that the covenant to maintain the property was backed by a permanent maintenance fund and that a portion of the purchase price paid by such purchaser would be placed in the maintenance fund."
5. "It was represented to each purchaser that the maintenance fund could not and would not be used for any other purpose."
6. The income from the maintenance fund has at all times been used for the maintenance and upkeep of the property sold, but by itself has been insufficient for that purpose.
7. For the most part the maintenance fund was invested in United States Liberty Bonds and War Savings Stamps.

8. The petitioner in its books of account did not treat the twenty per cent. of the selling price of such niches and vaults as part of its gross income.

These agreed facts are sufficient to exclude from appellant's taxable income the maintenance fund payments made during the years in question in accordance with the strictest rules laid down by the Board in the Los Angeles, Metairie and Inglewood cases. It is quite apparent that the Portland Association was in good faith endeavoring to build up a fund of sufficient size so that the income therefrom would be sufficient when all the property had been sold to provide adequately for permanent maintenance. All purchasers were informed of the existence of this fund. They were further informed that a portion of the amounts paid by them would be placed in this fund and that the fund would not and could not be used for any other purpose. It is stipulated that there were placed in *a permanent maintenance fund* amounts representing twenty per cent. of the selling price of urns, niches and vaults sold during the years in question. The importance of this stipulation is that the Government has recognized the fund itself as a permanent fund. The majority opinion of the Board to the effect that there was no more than a contractual obligation cognizable at common law and a means privately adopted by the corporation to fulfill it is not borne out by the facts. Not only

the income from the fund but the fund itself was devoted to this specific use. It did not and could not inure to the benefit of the corporation or its stockholders. Any misuse of the fund (and there is no suggestion that there ever was such misuse) would have resulted in the immediate taking away from the Association of the control of the fund and of the fund itself. Judged by standards of common sense, of plain intention and of legal effect, the maintenance fund was in the fullest sense a trust fund and being such was never income of the Association.

Mr. Arundell, the member of the Board who heard the case, wrote the dissenting opinion. He shows in detail that the facts in the Portland case bring it within the scope of the principles laid down in the Metairie and Inglewood Park cases. He shows that the presence of a state law forbidding the use of perpetual care funds for any other purposes may aid in establishing the fact of the existence of a trust but he shows that an equally valid trust may be created by the acts of the parties. No better or stronger summing up of the position of the appellant in this case could be given than that which appears in Mr. Arundell's dissenting opinion, the concluding paragraphs of which are as follows:

> "In both the Metairie and Inglewood cases there were express covenants concerning perpetual care, but there was nothing, other than oral representations to purchasers, as to the

fund to be held in trust. If an express trust can be gathered from oral representations in these cases, why does not the same rule apply here? But I do not think it necessary to decide in any of these cases whether the trust is express of implied; it is sufficient if either kind can be found. It has been often held that no technical language nor specific words are necessary to create a trust. As is said in *Chicago Rwy. v. Des Moines Rwy.*, 254 U. S. 196, 208:

> 'It needs no particular form of words to create a trust, so there be reasonable certainty as to the property, the objects and the beneficiaries. *Colton v. Colton*, 127 U. S. 300, 310.'

"There is here no lack of certainty, as urged by the respondent. The representations to purchasers and the deeds given them establish the purpose to which the funds were to be put and who the beneficiaries were. The records of the corporation determine the amount of the fund.

"The acts of the petitioner in representing to purchasers that it had a permanent maintenance fund, in covenating for perpetual care, and in formally setting aside a specified portion of the amounts received, we think were sufficient to create an enforceable trust. In *Holmes v. Dowie*, 148 Fed. 634, 638, it is said:

> 'It is a well recognized principle of equity that where a person accepts money or property to be used by him for the benefit of some other person or persons, or for the advancement of some lawful enterprise, such money or property constitutes a trust fund.'

"The prevailing opinion cites the decision in Springdale Cemetery Association, 3 B. T. A.

223. An essential difference between the cases is that in the Springdale case, it was found as a fact that:

> 'The corporation's by-laws contained no provisions for appropriating any part of the receipts from the sale of lots as such perpetual care fund, and no resolution to that effect was passed by the directors.'

"Nor does the case of Mead Construction Co., 3 B. T. A. 438, seem to be in point. There the sole question was whether a certain part of the amount due the taxpayer for paving work which was withheld by a municipality was income to the taxpayer; there was no question of whether any part of the amount received by the taxpayer was exempt from tax." (Transcript of Record, Pages 75-77.)

Respectfully submitted,

CAREY & KERR,

CHARLES E. McCULLOCH,

IVAN F. PHIPPS,

Attorneys for Petitioner and Appellant.